
Appointment of Severn Trent Services (Water and Sewerage) Ltd to serve Wellesley

On 9 October 2015, Ofwat began a consultation on a proposal to grant an appointment to Severn Trent Services (Water and Sewerage) Ltd ("STS") enabling it to become the sewerage services provider for a development in Thames Water's sewerage services area called Wellesley in Aldershot ("**the site**"). STS will serve the site by using a pre-existing private sewage treatment works owned by the MoD, rather than discharging to the public sewers of Thames Water. STS is a newly set-up subsidiary of Severn Trent Water, and is a new entrant into the sewerage sector in England and Wales. We have agreed a set of licence conditions with STS that will govern this new appointment, and any subsequent variations to it.

The consultation ended on 6 November 2015. During the consultation period, we received representations from two organisations, which we considered in making our decision. On 21 December 2015, we granted STS an appointment to enable it to supply sewerage services to the site.

This notice gives our reasons for making this variation.

Introduction

The new appointment and variation mechanism, specified by Parliament and set out in primary legislation, allows one company to replace the current company as the provider of water and/or sewerage services for a specific area. This mechanism can be used by new companies to enter the market and by existing companies to expand into areas where they are not the appointed company. In this case, STS applied to replace Thames Water as the appointed sewerage company for the site.

A company may apply for a new appointment (or a variation of its existing appointment to serve an additional site) if any of the following three criteria are met.

- None of the premises in the proposed area of appointment is served by the existing appointed company at the time the appointment is made (the "**unserved criterion**").

- Each premises is likely to be supplied with at least 50 mega litres per year (in England) or at least 250 mega litres per year (in Wales) and the customer in relation to each premises consents (“**the large user criterion**”).
- The existing water and sewerage supplier in the area consents to the appointment (“**the consent criterion**”).

When considering applications for new appointments and variations, Ofwat operates within the statutory framework set out by Parliament, including our duty to protect consumers wherever appropriate, by promoting effective competition. In particular, in relation to unserved sites, we seek to ensure that the future customers on the site – who do not have a choice of supplier – are adequately protected. When assessing applications for new appointments and variations, the two key policy principles we apply are:

1. customers, or future customers, should be no worse off than if they had been supplied by the existing appointee; and
2. we must be satisfied that an applicant will be able to finance the proper carrying out of its functions as a water and/or sewerage company.

Entry and expansion (and even the threat of such by potential competitors) can lead to benefits for different customers (such as household and non-household customers and developers of new housing sites). Benefits can include price discounts, better services, environmental improvements and innovation in the way services are delivered.

Benefits can also accrue to customers who remain with the existing appointee, because when the existing appointee faces a challenge to its business, that challenge can act as a spur for it to improve its services. We believe the wider benefits of competition through the new appointments and variations mechanism can offset any potential disbenefits for existing customers that might arise. We consider these potential disbenefits in more detail below.

The application

STS applied to be the sewerage services appointee for the site under the unserved criterion set out in section 7(4)(b) of the Water Industry Act 1991 (“**WIA91**”). STS will serve the site by using an existing sewage treatment works rather than discharging to the sewers of Thames Water.

Unserved status of the site

To qualify under the unserved criterion, an applicant must show that at the time the appointment or variation is made, none of the premises in the proposed area of appointment will be served by the existing appointee. We concluded that the site was unserved based on information provided to us by STS, which included that it will be using a private sewerage network (owned by the MoD) and that there are no sewerage assets owned by Thames Water on the site.

Financial viability of the proposal

We will only make an appointment if we are satisfied that the proposal poses a low risk of being financially non-viable. We assess the risk of financial viability on a site-by-site basis and also consider the financial position of the company as a whole.

Based on the information available to us, we concluded the site demonstrates sufficient financial viability, and STS has satisfied us that it can finance its functions and that it is able to properly carry them out.

Assessment of ‘no worse off’

STS will offer customers a 2.5% discount on the fixed and volumetric sewerage charges of Thames Water.

With regard to service levels, we have reviewed STS' Codes of Practice and its proposed service levels and compared these to the Codes of Practice and the performance commitments of Thames Water. Based on this review, we are satisfied that customers will be offered an appropriate level of service by STS and that overall customers will be ‘no worse off’ being served by STS instead of by Thames Water.

Effect of appointment on Thames Water’s customers

In considering whether customers will be no worse off, we also looked at the potential effects of this variation on the price that Thames Water’s existing customer base may face.

The calculation necessarily depends on a range of assumptions, and there are clearly difficulties involved in quantifying the effect on customers of Thames Water. It is therefore necessary to use a simplified set of figures. We have expressed the effect in ‘per bill’ terms to try and quantify the possible effect in an easily understandable way. Broadly, we have assessed the potential magnitude of this impact by comparing how much Thames Water might have expected to receive in

revenue from serving the site directly, with the revenues they might have expected from serving the site indirectly via a discharge agreement with STS. In this case, Thames Water do not earn any bulk discharge revenue as STS services the Site via its own network. The lower bound of the range takes into account the benefit to Thames Water as a result of STS serving the site, by estimating the costs that Thames Water is likely to avoid, such as retail costs and capital and operating costs associated with the local network used to serve the site. The upper bound of the range does not take these avoided costs into account. We look at these differences in revenue and costs over a hundred year timeframe to reflect the long-lived assets that will be used to supply customers at the site.

In this case, we have calculated that, there may be a potential impact on the bills of Thames Water's existing customers of between £0.08 and £0.10 per year. We are comfortable that this range accounts for the uncertainty in the costs that may be avoided by Thames Water.

This impact does not take into account the potential spillover benefits to customers arising from dynamic efficiencies achieved as a result of the competitive process to win new sites.

Developer choice

We take into consideration the choices of the site developer. In this case, the developer said that it wanted STS to be the sewerage company for the site.

Responses received to the consultation

We received two responses to our consultation; from the Environment Agency and the Consumer Council for Water ("**CCWater**"). We considered this response before making the decision to vary IWN's appointment. The points raised in the response are set out below.

Environment Agency

The Environment Agency considered there could be wider environmental benefits if we grant this appointment. It said discharges from wastewater treatment plants owned and operated by an appointed sewerage company are significantly less likely to cause pollution than those discharges from privately operated plants. It listed examples of these benefits, which include comprehensive and reliable effluent treatment and mechanisms in place to deliver upgrades and environmental improvement when required.

CCWater

CCWater expressed concerns at how new appointees in Thames Water's area will charge and particularly queried whether charges of new appointees should provide a discount to customers to take into account the Thames Tideway Tunnel (TTT) element of Thames Water's sewerage charge.

All Thames Water's sewerage customers contribute to the cost of building the TTT (as charges are regionally averaged). A new appointee's charges are linked to the charges of the incumbent which means in this case STS may not charge customers more than the charges of Thames Water, a charge that includes the TTT element.

We consider that we should not depart from our existing policy (the “no worse off” analysis) in assessing NAV applications in Thames Water's sewerage services area. Our reason for this is that this situation is not unique, given regional averaging of charges. While we could subject a new appointee to its own price control, this is not considered proportionate given the small size of new appointees areas.

Conclusion

Having assessed STS' application, and having taken account of the responses we received to our consultation, we decided to grant an appointment to STS to allow it to serve the site for sewerage services.